United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-2627

United States Court of Appeals
FOR THE SECOND CIRCUIT

No. 74-2627

PEERLESS MILLS, INC.,
Plaintiff-Appellant,

against

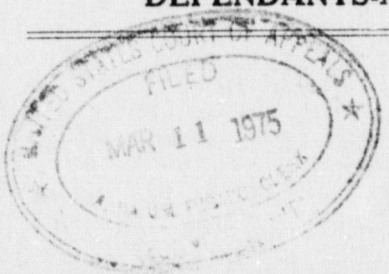
AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Defendant and Third-Party Plaintiff-Appellee,

against

HERTZ, WARNER & Co., a partnership and NORMAN CARNEY, PAUL COHN, VINCENT GENNA, MARTIN GILMAN, JOEL HELD, IRVING HERTZ, LOUIS KULIKOFSKY, JAY LEYNER, MILTON LITT, CHARLES MATTHEWS, ROBERT SADLER, JAMES SADLER, ROBERT SADLIER, JAY SALUC, KENNETH SHELDON and HENRY WARNER, general partners in Hertz, Warner & Co.,
Third-Party Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

DEFENDANTS-APPELLEES BRIEF



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Preliminary Statement

This is an appeal from the judgment of the United States District Court, Southern District of New York, Marvin E. Frankel, J., which was entered on November 6, 1974 dis-

missing plaintiff's claims against the defendant American Telephone & Telegraph Company (AT&T) and third-party defendants Hertz, Warner & Company, Irving Hertz and Henry Warner.

The plaintiff claimed that the third-party defendants, i.e., Hertz, Warner & Co., Irving Hertz and Henry Warner converted the capital contribution of Paul Cohn which in turn was given to him by the plaintiff Peerless Mills, Inc. The plaintiff also claimed that it was induced by a fraud practiced upon it and Paul Cohn by Irving Hertz and Henry Warner, to lend the 2,000 shares of AT&T stock which it also alleged was converted.

Issues Presented

1. Whether the plaintiff has standing to challenge the validity of the partnership agreement.

2. Whether fraudulent representations were made to Paul Cohn for the purpose of having them repeated to the plaintiff and whether, in fact, the plaintiff has proven the elements of common law fraud.

Summary of the Argument

1. The findings of fact of the District Court are conclusive on the plaintiff as to the question of fraud and conversion.

2. Any claim as to the validity of the partnership agreement and as to the relationship amongst general partners and others, cannot be contested or challenged by the plaintiff.

The Facts

Paul Cohn was a founding partner of Hertz Neumark & Warner when the firm was founded. (16a) At the time that he became a partner he made a capital contribution of

$15,000.00 and received a five per cent share of profits, became an allied member of the New York Stock Exchange and otherwise enjoyed the privileges and respect normally accorded a partner of a brokerage firm (108a, 115a, 125a, 223a, 234a).

He withdrew as a partner of Hertz, Neumark & Warner in 1965 because, among other things, he was not allowed to participate in the decision making process which was carried on by the Executive Committee, and was not given adequate financial data about the Company (76a, 110a, 111a).

After withdrawing as a general partner of Hertz, Neumark & Warner, he became an employee of the firm and worked as a registered representative. Thereafter, he became the head of the syndication department and as such he was responsible for the sale by the Company of large blocks of securities in which Hertz, Warner was either an underwriter, co-underwriter or selling group member (112a, 113a, 274a, 275a, 276a).

In March or April, 1969, discussions were held between Cohn, Hertz and Warner in which Paul Cohn indicated that he was interested in becoming a partner of the firm again and his application for membership was approved by the Executive Committee (274a, 236a). The terms under which he was to become a partner was that he was going to make a $100,000.00 capital contribution. He was to receive three per cent of the profits, he was to receive a salary of $15,000.00 per year and he was to share in the losses at the ratio of four and one-half per cent (81a). These terms and conditions were included in the 1969 partnership agreement which he signed (305a).

The 1969 partnership agreement became effective as of July, 1969 in that from that date onward, Cohn was

treated as a partner. He received a draw instead of a salary; his name was submitted to the New York Stock Exchange; and he became an allied member of the Exchange. The fact of his becoming an allied member was published by the New York Stock Exchange. He held himself out in the community as being a partner, attended partnership meetings and formed a junior executive committee with several other general partners who were not members of the Executive Committee (121a, 136a, 167a, 168a, 198a, 199a).

At no time did Cohn disavow his status as a partner, nor did he take any action to terminate his position as a general partner. He didn't inform anyone that he had misgivings about his being a general partner. Neither did he take any legal action which would have resulted in a disclaimer of his partnership interest until after the fact. He didn't require in writing that his contributon be returned when he was fired by Irving Hertz for surreptitiously transfering 2,000 shares of AT&T from the Hertz, Warner account to the name of Peerless.

Hertz, Warner in January, 1969, commenced closing down some of its branch operations, consolidated its retail business and emphasized the professional aspects of the brokerage business. That is, they were phasing out their retail business and contemplated only having one office in which to conduct this business. Cohn was well aware of these facts (121a, 122a, 123a, 216a, 217a, 278a, 279a, 281a).

The gravamen of Paul Cohn's allegations of the commission of fraud and deceit, misrepresentation and nonrepresentation concerns the financial status of the firm. This point is expressly contradicted by Hertz who testified that Cohn had full access to the financial reports of the firm and was well aware of the financial affairs of the Company and became a partner with full knowledge of the situation (237a, 238a, 239a, 240a). In addition, Paul Cohn had an

obligation to ascertain the facts that he deemed relevant prior to becoming a partner. He completely neglected this obligation and tried to put the burden on Warner by stating that he relied solely upon Warner's representations (129a, 130a). Warner denied making the statements attributed to him (284a, 285a). Cohn testified in detail what the requirements of "due diligence" were for a registered representative but offered no explanation why he did not exercise this same degree of care with his own investments (114a, 115a, 116a, 117a, 136a, 137a). We submit that any casual conversations which he may have had with Hertz and Warner are not a substitute for financial information, but that financial information was available in the form of books and records of the firm and periodic financial statements sent to customers of the firm or filed with the New York Stock Exchange. He had an obligation to examine those records if he felt that the information contained therein was relevant or material to his becoming a partner.

Cohn's testimony is completely rebutted by the plaintiff's witness, Arthur Meyer ("Meyer"). Meyer testified that he received the financial reports of Hertz, Warner prior to making his investment. He stated that he received the reports for three consecutive years and he made his decision to invest in the firm based upon these financial reports (226a).

Meyer, who is admittedly an expert at analyzing financial statements, would have questioned the fact that Hertz, Warner earned $1,000,000 during half of a fiscal year and then lost $900,000.00 during the second half of the year (226a).

It is unworthy of belief that an investor such as Meyer would have the access to the financial reports of the firm but that Cohn would not. This is especially true in light of the fact that the year end financials were sent to each person who had an account with the firm (483a).

The plaintiff would have us believe that Hertz, Warner and Hertz and Warner would commit fraud to obtain Cohn's capital contribution because the firm was in such dire financial straits. This allegation is completely controverted by the financial statement of November 2, 1969, (third-party defendants exhibit "A") (483a), which states, among other things, that the total assets of the firm as of that date was $53,471,384. In addition, the total capital in the firm as of that date was $10,286,516. Therefore, all this alleged fraud and misrepresentation was commited by the firm to obtain two-tenths of one per cent of the total capital of the firm.

The record also indicates that Cohn was a very unstable person with regard to his position with Hertz, Warner and his personal commitments. Cohn became a founding partner of Hertz, Neumark and Warner in October, 1963 (75a). He signed a partnership agreement at that time and made a capital contribution of $15,000.00, which he borrowed from his father. He received a draw and a share of the profits (108a, 109a, 110a, 111a). Cohn, in 1965, resigned as a general partner at a time when the firm was prospering and continued to work as a registered representative for the firm (233a, 234a). The reason he gave for resigning from the firm was "I was not called upon to be involved in any decision-making processes of the firm" (76a).

In 1969, when Cohn again became a general partner, he signed a partnership agreement. He borrowed the amount of his capital contribution, held himself out as a general partner, but later changed his mind about being a partner (136a, 141a, 142a, 93a, 94a). The first time he resigned he informed Hertz of this fact, the second time he didn't bother to notify any Executive Committee members. The record is replete with conferences between Cohn and his attorneys but bare of any reference to any action taken

to withdraw as a partner or to obtain his capital contribution back by legal process (141a, 142a).

Cohn felt no particular commitment to repay the loan from his father and the record does not disclose any plans on his part to repay his loan from Peerless (109a). He did not seem at all troubled or concerned about the fact that he owed Peerless $100,000.00 and that he might have to pay an additional amount if Hertz, Warner was successful in the arbitration presently pending between them before the New York Stock Exchange (138a).

The stock which Cohn used to make his capital contribution was borrowed from the plaintiff. These parties executed a "Securities Loan Agreement" on or about October 31, 1969 (135a) (third-party defendants exhibit "B"). Thereafter, both the plaintiff and Cohn treated the AT&T shares as Cohn's property (132a, 133a, 135a, 139a). Cohn decided to pay the dividends received from AT&T to Peerless (139a). This was consistent with the "Securities Loan Agreement" which provided that "Paul Cohn *may* contribute the same [the shares] to the firm of Hertz, Warner & Co. . . . as a contribution of capital by *him*" (emphasis supplied). This agreement further provided that Peerless' claim is solely against Paul Cohn and that Hertz, Warner is relieved of any liability to Peerless as a result of the agreement. Therefore, Peerless cannot maintain the instant action against Hertz, Warner & Co. or Hertz and Warner but can only sue Cohn. This is the just result in view of the fact that Cohn is contesting the same issues, i.e. the validity of the partnership and his status as a partner in an arbitration before the New York Stock Exchange (138a).

The Court should note that the evidence adduced in this case is consistent with the theory that the "loan" of 2,000 shares of AT&T stock between Peerless and Cohn may have been, as between Peerless and Cohn, a gift. The

"Securities Loan Agreement" provides that Cohn will repay the loan on November 1, 1970. Cohn testified that Peerless never made a demand upon him for the stock and never expressed an intention to sue him for it (135a). The plaintiff's witness, Mrs. Margaret Fine, in her deposition (472a) stated:

> "Q. Has Peerless Mills, Inc. made any efforts to collect on its loan from Paul Cohn? A. No, I guess.
>
> Q. Has a demand been made against Paul Cohn that he pay over two thousand shares to Peerless Mills, Inc.? A. No."

The issue of the status of Peerless and Cohn to the "Securities Loan Agreement" was not before the Court even though this issue could have been litigated had the plaintiff chosen to allege such a cause of action against Cohn after he was made a third-party defendant by AT&T. Since the plaintiff has litigated this issue directly it should not be permitted to attack the validity of the agreement collaterally. We submit that the "Securities Loan Agreement" precludes the plaintiff from recovery against Hertz, Warner & Co. and therefore Hertz and Warner individually in this action.

The plaintiff attaches significance to the fact that Cohn's capital contribution was borrowed from his in-laws with the knowledge of Hertz and Warner. Cohn testified that he didn't tell anyone that the stock would be coming from Peerless (84a). Joel Held drew the agreement for the loan between Cohn and Peerless from an agreement he had previously drawn, only changing the names (176a, 177a). Hertz testified that it was a standard form that was used whenever securities came from a third party (252a, 253a). Held provided Cohn with a form that was used by the firm and that was the firm's total involvement with the transaction.

The status of the Meyer-Blau group was not a factor in whether or not Cohn became a partner nor whether or not Peerless would have made the loan to Cohn. Cohn testified that he first inquired about the Meyer-Blau group when Held brought him the partnership agreement to sign. This was a month or two after the AT&T stock transferred into his capital account (140a). It was also five months after he became a partner (136a). He never inquired as to the Meyer-Blau status when he discussed the offer of partnership in March or April, 1969 (136a, 137a), and didn't think the status of the Meyer-Blau group was of any consequence when he contributed his capital to the firm (141a). He claims to have relied solely on a hearsay statement made by Held and offers no explanation as to why he did not check with Hertz as to the true facts of the situation (140a). Held was allegedly told that the Meyer-Blau group signed the agreement (160a). But held was the person who was in charge of obtaining the signatures and therefore, was in a position to know whether or not they had signed it (166a). In any event, the status of the Meyer-Blau group could not have been relevant to Peerless in deciding whether or not to make the loan since the loan had been consummated prior to Cohn's becoming concerned about the issue.

The partnership agreement signed by Cohn, effective as of July 1, 1969, contained no conditions precedent to the effect that the acceptance of the agreement by the Meyer-Blau group nor that the payment of their money was a condition precedent to the agreement becoming effective. Neither did any prior drafts of the agreement contain such a stipulation (Plaintiff's Exhibit 1) (191a, 192a).

The general partners of Hertz, Warner were chosen by merit and not for their capital contributions (183a, 184a, 275a). The limited partners and general partners changed frequently as partners came and went. The number of

partnership points changed frequently and this necessitated amendments to the agreement (185a, 186a). It strains credibility to believe that the change in the Meyer-Blau group's status and contribution from the 1968 agreement to the 1969 agreement was a m[illegible]sideration in whether or not Cohn would sign [illegible]tnership agreement.

POINT I

Findings of fact of the District Court are conclusive on the Plaintiff and cannot be overturned.

The Trial Court found, as fact, as the trier of fact, that the necessary elements needed for plaintiffs legal theories for recovery against the third-party defendants, was lacking. Based upon the testimony of all of the witnesses made findings of fact as follows:

> Paul Cohn broached Henry Warner with the idea of becoming a partner (59a).
>
> Paul Cohn was not at any time interested in the financial affairs of Hertz, Warner (60a).
>
> Paul Cohn was inattentive over the years to the firms profitability (60a).
>
> Paul Cohn made no inquiries about current profit and loss figures in early 1969 (60a).
>
> If Paul Cohn had wanted information he would have had it (60a).
>
> "The causes of the losses were not fully appreciated by those in charge of the firms affairs" (60a).
>
> Paul Cohn knew of the decision to close branch offices of Hertz, Warner (60a).
>
> Nobody knew of the coming bad times in Wall Street (61a).
>
> Hertz, Warner signed a three-year lease for office space in March, 1970, not knowing of the impending collapse (61a).
>
> Problems of the transition were visible to Paul Cohn (61a).

There were no fraudulent statements or omissions to Cohn by any members of the firm (62a).

There was no deception of the Fines (Peerless Mills, Inc.) (63a).

Paul Cohn had made no conditions or prerequisites to becoming a partner (64a).

Paul Cohn intended to become a partner (67a).

Paul Cohn agreed with others to become a partner without reservations or restrictions (67a).

Meyer-Blau's signing of the partnership agreement was not in Paul Cohn's mind when he signed the partnership agreement (68a).

The representations made to Cohn were not made for the purpose of having repeat them to his in-laws (69a).

POINT II

Cohn became a general partner of Hertz, Warner and Peerless has no standing to litigate the valadity of the partnership agreement.

The partnership law of the State of New York Section 10(1) only requires that two or more persons agree to form an association to carry on as co-owners of a business for profit. Therefore, if Paul Cohn and only one other person signed the 1969 partnership agreement, a valid partnership would have been formed. A valid partnership was formed at the time of the general partners agreed to become partners, prior to July 1, 1969, *Keen* v. *Jason,* 19 Misc. 2d 538, 187 N.Y.S. 2d 825, *affirmed* 11 A.D. 2d 1039, 207 N.Y.S. 2d 1001. The issue of whether Paul Cohn became a partner of Hertz, Warner is presently being litigated between Paul Cohn and Hertz, Warner in an arbitration proceeding presently pending before the New York Stock Exchange. It is the respondent's contention that the question of partnership belongs solely to Paul Cohn.

Peerless entered into a securities loan agreement with Cohn and pursuant to the terms of that agreement lent Cohn 2,000 shares of AT&T common stock which Cohn agreed to repay. (Third-Party Defendant's Exhibit B.) The agreement specifically provides that Hertz, Warner:

> "shall not be under any liability to Peerless Mills, Inc. by reason of this agreement nor shall it be under any obligation whatsoever to Peerless Mills, Inc. on account of said cash and stock or any interest thereon, stock dividends or rights received by Paul Cohn for the firm."

This agreement, precludes the instant action by the plaintiff against Hertz, Warner. The third-party defendants can assert this agreement as a defense to this action on the basis that they are third-party beneficiaries of this contract, *Lawrence* v. *Fox,* 20 N.Y. 268.

The plaintiff had an opportunity when it served its amended complaint to litigate the issue of the validity of the securities loan agreement by placing this agreement in issue between itself and Cohn who was named a third-party defendant in this action. The plaintiff chose not to assert this claim directly against Cohn but is attempting to attach the agreement collaterally by claiming that there was a breach of or a failure of consideration between Cohn and Hertz, Warner.

Since the plaintiff was not a party to the partnership agreement signed by Cohn, there is no privity of contract between the plaintiff and Hertz, Warner. The lack of privity to a contract, precludes the plaintiff from suing for a breach of this contract or to enforce the contract. *Seaver* v. *Ransom,* 224 N.Y. 233, 120 N.E. 639; *Lorrilard* v. *Clyde,* 122 N.Y. 498, 25 N.E. 917; *Ebbe* v. *Harry N. Stevens, Inc.,* 286 A.D. 998, 144 N.Y.S 2d 576, *affirmed* 1 N.Y. 2d 846, 135 N.E. 2d 728.

The plaintiff further urges the Court to find in its favor based upon the fact that the securities loan agreement was executory and never became effective because Cohn never became a partner The testimony adduced at trial and the cases cited herein established that Cohn was a partner of the firm and this finding is consistent with his actions. In addition, he is estopped from claming that he was not a partner of the firm and Peerless lacks standing to litigate the issue of whether or not he became a partner of the firm. In view of the documents executed by Cohn, if Hertz, Warner is called upon to return the 2,000 shares of AT&T stock then the only person to whom the stock should be returned would be Cohn. Since Cohn has not sued for affirmative relief in this action, this fact would preclude a finding in favor of the plaintiff and against Hertz, Warner. Therefore, Cohn should properly be left to his remedy in arbitration which is presently pending before the New York Stock Exchange.

In order for the plaintiff to succeed in this litigation, it must contradict the terms of two agreements, both of which are clear and unambiguous. Since the security loan agreement is clear in its terms, the plaintiff cannot be heard to contradict or explain this agreement, *Corse* v. *Peck,* 102 N.Y. 513, 70 N.E. 810. The plaintiff must, therefore, show fraud in the inducement in order to prevail in this action.

CONCLUSION

The findings of fact of the District Court eliminate any possible finding of fraud. Without fraud, the plaintiffs only possibility of recovery would be based in contract and those claims may only be argued by Paul Cohn, who is not the plaintiff in this action. Accordingly, it is respectfully submitted by the third-party defendants that the judgment of the District Court should be affirmed.

Respectfully submitted,

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